

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 256 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

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1. Whether Reporters of Local Papers may be allowed to see the judgements?
2. To be referred to the Reporter or not?
3. Whether Their Lordships wish to see the fair copy of the judgement?
4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?
5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF INCOME TAX

Versus

ANANT NARHAR NIMKAR(HUF)

Appearance:

MR. M.J.THAKORE for MR MANISH R BHATT for Petitioner
MR. J.P. SHAH, Advocate for Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

Date of decision: 27/11/96

ORAL JUDGEMENT (Per R.Balia,J.)

At the instance of the Revenue the Income Tax Appellate Tribunal, Ahmedabad Bench "B" has referred the following question arising out of its order in ITA No.1385/Ahd/81, relevant to assessment year 1973-74:-

"Whether on the facts and in the circumstances of

the case, the Tribunal was right in law in coming to the conclusion that the compensation amount of Rs. 1,88,950/- received by the assessee as per arbitration award dated 12.7.1972 on retirement is not taxable as capital gain?"

The facts giving rise to this question as found by the Tribunal are that the assessee was a Partner in the firm Messrs Elmex Industries and as a result of some disputes between the Partners, the assessee HUF ceased to be Partners in all the group of firms including Messrs Elmex Industries. On a reference being made to the Arbitrator, according to the award, the assessee retired from the firm with effect from 31.12.1971 and has received an amount of Rs. 1,88,950/- attributable to the value of his share in the firm on retirement, apart from other sums which are not subject matter of controversy before us. The Assessment Officer, as a result of proceedings taken out under Section 263 of the Income Tax Act by the Commissioner of Income Tax, made additions of Rs. 2,15,806/- in the income of the assessee, which was received by him as a result of award for the assessment year 1973-74. The Commissioner (Appeals) held that out of aforesaid sum Rs. 1,88,950/- are to be included in the income of assessee for the assessment year 1973-74 as capital gains arising from transfer of his share in the firm to continuing partners. On appeal before the Tribunal, the Tribunal held that the said amount received on retirement of the Partner as a share in the firm is not exigible to tax and deleted the additions.

The question that arises for our consideration is whether amount of compensation awarded by the arbitrator which has been taken to be as a value of the assessee's share in the assets of firm at the time of his retirement, amounts to transfer of capital assets by the Partner to reconstituted firm for a consideration and results in capital gain as defined under Section 45 of the Income Tax Act, 1961 as it stood at the relevant time?

The issue is no more res integra. The principle was clearly stated by this Court in Commissioner of Income Tax, Gujarat Vs. Mohanbai Pamabhai, reported in 91 ITR 393 enunciating the nature of interest of a Partner in a Partnership firm and resultant position arising from realisation of such interest on dissolution of the firm or retirement of the Partner allowing the other Partners to continue in the firm - P.N.Bhagwati, Chief Justice, as he then was, speaking for the Court observed as under:-

"The interest of a partner in a partnership is not interest in any specific item of the partnership property. It is a right to obtain his share of profits from time to time during the subsistence of the partnership and on dissolution of the partnership or on his retirement from the partnership to get the value of his share in the net partnership assets which remain after satisfying the debts and liabilities of the partnership. When, therefore, a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges is determined on taking accounts on the footing of notional sale of the partnership assets and given to him, what he receives is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. His share in the partnership is worked out by taking accounts in the manner prescribed by the relevant provisions of the partnership law and it is this namely, his share in the partnership which he receives in terms of money. There is in this transaction no element of transfer of interest in the partnership assets by the retiring partner to the continuing partners.

The transfer of a capital asset in order to attract capital gains tax must be one as a result of which consideration is received by the assessee or accrues to the assessee. When a partner retires from a partnership what he receives is his share in the partnership which is worked out and realised and does not represent consideration received by him as a result of the extinguishment of his interest in the partnership assets."

In Malabar Fisheries Co. Vs. Commissioner of Income Tax, Kerala - 120 ITR P.49, P.N.Bhagwati, J. as he then was, speaking for the Court observed as under:-

"A partnership firm under the Indian Partnership Act, 1932, is not a distinct legal entity apart from the partners constituting it and equally in law the firm as such has no separate rights of its own in the partnership assets and when one talks of the firm's property or the firm's assets all that is meant is property or assets in which all partners have a joint or common interest. It

cannot, therefore, be said that upon dissolution, the firm's rights in the partnership assets are extinguished. It is the partners who own jointly or in common the assets of the partnership and therefore, the consequence of the distribution, division or allotment of assets to the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between partners and there is no question of any extinguishment of the firm's rights in the partnership assets amounting to a transfer of assets within the meaning of S. 2(47) of the I.T Act, 1961. There is no transfer of assets involved even in the sense of any extinguishment of the firm's rights in the partnership assets when distribution takes place upon dissolution."

In Addanki Narayanappa Vs. Bhaskara Krishnappa AIR 1966 S.C 1300, the Supreme Court while considering the nature and character of the property which the firm acquires whether by way of contribution from Partners or accretions during the continuance of the business said "since a firm has no legal existence, the partnership property will vest in all the partners and in that sense every partner has an interest in the property of the partnership"

Dealing with the nature of partners' right qua the property, the Court went on to say : "that the whole concept of partnership is to embark upon a joint venture and for that purpose to bring in as capital money or even property including immovable property..... the right during subsistence of the partnership is to get his share of profit from time to time as may be agreed upon among the partners and after the dissolution of the partnership or that his retirement from partnership of the value of his share in the net partnership asset as on the date of dissolution or retirement after deduction of liabilities and prior charges."

Thus, the Court clearly expressed that what a partner gets on dissolution or retirement of the firm is value of his own share and also held that the dissolution of the firm does not result in extinguishment of anybody's right, but is adjustment of shares according to one's interest in the assets hitherto enjoyed jointly.

It is also settled what a partner gets at the time of his retirement is not through transfer of an asset for the consideration. What really he gets at the

end of the relationship with the firm is the value of the interest he already had in the firm which he was enjoying jointly and which grows or diminishes with the growth or fall in the prosperity of the partnership firm. he does not get any new right at the time of dissolution or his retirement.

In the case of Sunil Siddharthbhai Vs. CIT, Ahmedabad - 156 ITR P.509, the apex Court said as follows:-

"It has sometimes been said, and we think erroneously, that the right of a partner to a share in the assets of the partnership firm arises upon dissolution of the firm or upon the partner retiring from the firm. We think it necessary to state that what is envisaged here is merely the right to realise the interest and receive its value. What is realised is the interest which the partner enjoys in the assets during the subsistence of the partnership firm by virtue of his status as a partner and in accordance with the terms of the partnership agreement. It is because that interest exists already before dissolution, as was held by this court in Malabar Fisheries Vo. V. CIT (1979) 120 ITR 49 (SC), that the distribution of the assets on dissolution does not amount to a transfer to the erstwhile partners. What the partner gets upon dissolution or upon retirement is the realisation of a pre-existing right or interest."

Thus, it is apparent that Court in Sunil Siddharthbhai's case reiterated the view taken in Malabar Fisheries' case that the distribution of the asset on the dissolution does not amount to a transfer to the erstwhile partners. If there is no transfer of assets to the partner concerned, the question of arising of a capital gain on transfer of a capital assets would not arise.

The aforesaid decisions state the position of law clearly that what the partner gets at the time of dissolution or upon retirement is realisation of his own pre-existence of right or interest in the firm and no transfer of property in his favour which is not already his takes place. If that is so, it cannot amount to transfer of partner's interest on getting value of his share on retirement. Obviously, realisation of one's own interest in money value after evaluating the value of

existing interest in the firm cannot in any terms be considered as transfer unless a legal fiction exists to that for that purpose and in the absence of any transfer, there cannot be any question of arising of any capital gains for taxable purpose.

Relying on the decision in the case of Sunil Siddharthbhai Vs. CIT, Ahmedabad - 156 ITR 509, the Supreme Court in 165 ITR 166 affirmed the decision of this Court in Mohanbhai Pamabhai's case referred to above (91 ITR 393). This Court had also occasion to consider the issue whether on retirement of a Partner any receipt in lieu of his share in Partnership assets amounts to sale, in the case of CIT, Gujarat V Vs. Dilip Engineering Works - 129 ITR 688. Justice S.B.Majmudar, as he then was, negatived the contention of the Department and observed that where a retiring partner receives a share in the partnership, any cash or any other asset, it cannot be said that any asset is transferred or sold to him. As held in 196 ITR 379 to which one of us (Hon'ble R.K.Abichandani,J.) was party, held that the amount received by the assessee on his retirement from the firm was not assessable and cannot be exigible to capital gains tax either under Section 45 or under Section 28(iv) of the Act, 1961, after referring to decision of this Court in Mohanbhai Pamabhai's case as affirmed by the Court in 165 ITR 166.

It must therefore, be held that receipt of any sum by a partner on his retirement from the firm or on dissolution of the firm as value of his share in the assets of the firm, does not involve any transfer of capital asset resulting in accrual or receipt of income chargeable to tax as capital gain in the hands of recipient partner, and the Tribunal was justified in not treating the amount of Rs. 1,88,950/- taxable as capital gain.

Accordingly we answer the question of law referred to us in affirmative - that is to say, in favour of the assessee and against the Revenue. No costs.
